



October 1, 2007

Defense Acquisition Regulations System
Attn: Mr. John McPherson
(OUSD AT&L DPAP(CPF), IMD 3C132)
3062 Defense Pentagon
Washington, DC 20301-3062

Re: DFARS Case 2006-D066, "Payments on Cost-Reimbursement Contracts for Services" 72 FR 42366, August 2, 2007

Dear Mr. McPherson:

The Aerospace Industries Association (AIA) is pleased to provide comments on the Department of Defense (DoD)'s proposed rule to amend the Defense Federal Acquisition Regulations Supplement (DFARS) to revise the payment terms for billings associated with cost type contracts for services.

AIA is the premier aerospace industry trade association, representing the nation's major manufacturers of commercial, military, and business aircraft, helicopters, aircraft engines, missiles, spacecraft, materials, and related components and equipment. AIA's member companies employ more than 635,000 highly-skilled engineering and manufacturing workers in the U.S. aerospace and defense industry. Our companies are major suppliers to the U.S. Government and our interest in the proposed rule is significant.

Before commenting on the significant impact of the proposed changes in the timing of interim payments on cost type contracts for services, we would like to provide background on how we reached a point where a change is being proposed that is clearly inconsistent with the intent of the Congress in drafting Section 1010 of the National Defense Authorization Act (NDAA) of 2001. Through Section 1010, Congress required agencies to pay interest on interim payments under cost-reimbursement services contracts because Congress became aware of the fact that payments under these types of contracts were being paid far in excess of thirty days; some greater than 45 days. In revising the Prompt Payment Act (PPA), effective 12/15/2000, to implement the 2001 NDAA, OMB stated in the Background Section that "neither Section 1010 of the NDAA nor this interim final rule is intended to modify current agency practices or policies regarding dates for payments for interim payments on cost-reimbursement service contracts, other than to require... that PPA interest payments be paid on interim payments that are made more than 30 days after the agency receives a proper invoice." OMB added that "Section 1010 leaves unaffected existing agency policies that call for these interim payments to be made well in advance of 30 days. For example, it is the policy of the Department of Defense to generally pay contractors 14 days or less after being billed for reimbursements on cost-reimbursement contracts." In the same Background section, OMB also pointed out that the accelerated

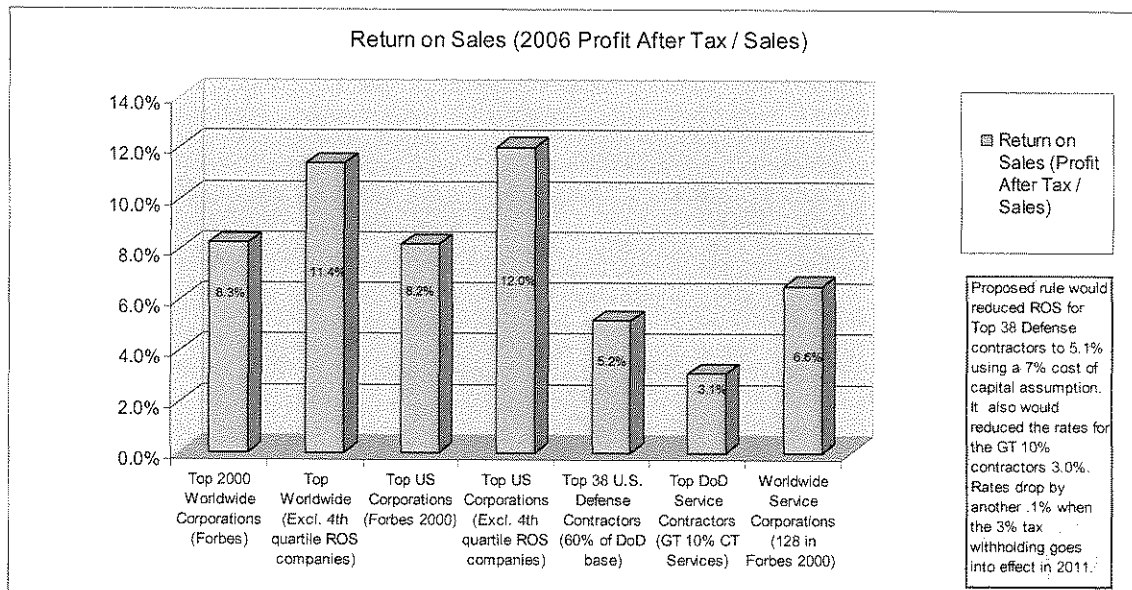
implementation of the PPA revision to require interest payments on interim financing payments on services contracts that exceed thirty days is a recognition that “prompt payment facilitates the government’s ability to attract high quality contractors, and *can reduce contractors’s cost of doing business with the government, which can translate into lower prices for products and services that agencies acquire to meet their mission.*” (Italics added.)

OMB issued a final rule on December 30, 2002 implementing the above-mentioned PPA revisions made effective 12/15/2000, with a change that made the interest payment requirement applicable to “all interim payment requests that are due on or after December 30, 2000 under cost-reimbursement service contracts awarded before, on, or after December 15, 2000.” This effectively exempted from the interest payment requirement invoices that were due to be paid prior to December 15, 2000.

Unfortunately, OMB’s 12/30/02 final rule revising the PPA and DoD-initiated implementing revisions to the FAR on 12/18/2001 revised the provisions that defined “contract financing” to exclude “interim payments under cost-reimbursement service contracts,” and to effectively classify these payments as “invoice payments.” So even though DoD (by its changes to DFARS 232.906 Making payments) and OMB intended to implement Section 1010 of the 2001 NDAA to leave unaffected “existing agency policies that call for these interim payments to be made well in advance of 30 days,” their implementation efforts were flawed, and industry failed to recognize those defects when the interim/final rules were issued.

With this background, we would like to address the impact of the proposed change to add paragraph 216.307 (under Subpart 216) of the DFARS to require that invoices on cost type contracts for services with large businesses be paid in 30 days. The Department of Defense is the largest buyer of goods and services in the world. Its immense buying power and highly refined acquisition strategies have resulted in a marketplace where large and small businesses alike compete to provide some of the most technologically advanced goods and services in the world at margins that are considerably lower than that achieved in the economy as a whole. In 2006, the Return on Sales, which is a key profitability indicator, for the top 2000 corporations in the world averaged 8.3%. During that same period the top 38 U.S. based Defense contractors responsible for 60% of the Department’s purchase base achieved a rate of only 5.2%, and those companies with cost type services sales accounting for more than 10% of total sales achieved a rate of only 3.1%. The rate of return achieved by Defense service contractors is also less than half that achieved by worldwide service companies in the top 2000 average.

If the proposed rule is implemented and the fees provided on services contracts are not adjusted the returns for the industry will decline by 2 to 3% (5.2% margin becomes 5.1% and 3.1% drops to 3.0%). The impact on Return on Assets for DoD contractors is even more dramatic as the change would impact both the asset and return sides of the financial equation. The Return on Assets for DoD contractors with more than 10% of their sales in the cost type for services contract category would experience an 8% reduction in the rate of return (5.0% to 4.6%). Over time, lower margins and increased working capital levels caused by implementation of the proposed rule will adversely impact the DoD’s ability to attract and retain the best capabilities of qualified businesses necessary to maintain a viable industrial base, which is essential to the future of our National Security. (See chart below)



Paying contract financing invoices for services in 30 rather than 14 days will over time increase the cost of services procured by the Department of Defense. The largest increase will come in the form of upward adjustments to margins that contractors will require to finance the growth in working capital necessary to perform under the contract. At current outlay levels for DoD services contracts, the financing cost for industry is expected to **increase by \$147 million annually**. In addition, contractors will need to revise internal policies and guidance to ensure proper bidding and accounting for contracts under the new rule. The guidance will need to be communicated and training will be required given the significant impact the rule will have on margins and working capital. If each of the several thousand Department of Defense service contractors (i.e., large businesses) expends even just \$5,000 to document, train, and communicate this important change, the total recoverable expense for industry to implement the proposed rule **would exceed \$10 million**. One could argue that many will actually spend significantly more than \$5,000 to ensure the rule is understood and accurately reflected in all future bids. Contractors will encounter significant challenges in accurately bidding, administering, and invoicing mixed types of contracts with mixed kinds of effort. It should also be noted that non-profit organizations receive more than \$3 billion of cost type contracts for services each year. The fact that they are not exempted from the requirement will adversely affect **their working capital levels by \$122 million**.

The Defense Finance and Accounting Service (DFAS) will also incur additional expense in implementing the proposed rule. While the DFAS preliminarily estimated that the cost to accommodate the proposed rule in one of its major payment systems would not exceed \$100,000, we believe the complex logic required to accurately handle payments especially on mixed type and kind contracts will cost significantly more. For example, there are many cost type contracts that contain services as well as research and development effort making the assignment and application of terms problematic given that none of the current DoD payment systems can accurately accommodate more than one set of payment terms for a particular invoice type on a contract. The logic changes implemented in each of the Department's payment systems will need to correctly apply payment terms logic that consider the effective date of the regulation,

differentiate between small and large businesses, distinguish between different prompt payment clauses on contracts that have cost and fixed price effort, and handle different terms on contracts containing services and other than services work scopes. We note that the DFAS estimate of costs applied only to its MOCAS system; it did not include changes required to other acquisition/contract writing systems (e.g., SPS, CONWRITE, DPACS, AMIS, etc.) and other DFAS pay systems (e.g., IAPS, CAPS, etc.). Therefore, the effort to modify these other DoD acquisition /payment systems that process cost type contract for service billings could, in our opinion, bring the total expense for DoD to accurately implement the rule to **well over a million dollars, and it is possible it will run into millions of dollars.**

While the above is our principal objection to the proposed change in payment terms for cost type services contracts, we feel compelled to comment on the findings contained in the DoD Inspector General (IG)'s Report on Providing Interim Payments to Contractors in Compliance with the Prompt Payment Act (Report No. D-2006-108). The proposed change was clearly the direct result of the DAR Council opening a case to consider the IG's findings and recommendations. While the IG report did clearly point out the flaws in OMB's and DoD/GSA's implementation of the NDAA of 2001, its recommendations for changing payment terms did not give full consideration to the economic benefits of DoD's long established policy of making contract financing payments as soon as possible. This resulted in a seriously flawed conclusion that terms for interim payments on cost type contracts for services should be extended to 30 days. DoD's policy of making contract financing payments as soon as possible incorporates the concept in FAR 32.005 (a) that contract financing consideration should reduce negotiated contract pricing, and that concept is reflected in the profit policies established in DFARS 215.404.4 and DoD weighted guidelines for calculating profit. To lower a contractor's bid or price in contract negotiations to provide contract financing and then not make contract financing payments as soon as possible is clearly an inequitable contracting policy. For example, the IG report noted that terms offered by DoD under cost type contracts for services were not in line with those offered by other Federal agencies. (DoD appeared to accept the IG's point by noting that the proposed change to pay cost type services invoices with large businesses "is consistent with the policies of other Government agencies, which do not pay in 14 days.") What this finding by the IG ignores is the fact that the cost type contract profit objectives for DoD contractors set forth in DFARS 215.404-4 and the weighted guidelines found at 215.404-71 are lower than those established for other Federal contractors in FAR 15.404-4, and the difference is primarily attributable to the accelerated financing provided by DoD (i.e., up to 10% for CPFF contracts awarded to other Federal contractors vs. 8% for DoD CPFF contracts).

The IG also draws unfavorable comparisons between payment terms for fixed price contracts for services versus cost type contracts for services (pages 5 and 6 of the IG report), effectively claiming that they should be paid in the same timeframe. Again, the IG ignores the fact that margins recommended in DoD's Weighted Guidelines profit objectives for fixed price services contracts are almost double those for cost type services contracts (normal values are 10.0% for fixed price contracts vs. 5.5% for cost type contracts). While much of the difference is associated with the greater risk under a fixed price contract, a portion of the profit is clearly associated with the fact that the cost type contracts receive more favorable terms and financing. The IG's recommendation that DoD should "treat all contractors the same" by making payments for fixed price and cost type services contracts in the same timeframe would become even more

problematic if the proposed rule is adopted because invoices under cost type contracts for services would be paid in 30 days and invoices for cost type contracts for maintenance, facilities, and research would be paid in 14 days. This is particularly true in the case of maintenance contracts because the guidance in the FAR and DFARS does not adequately discriminate between the two types of contracts—maintenance and services. Our review of the DD350 contract reporting system shows that 14% of the contract dollars awarded under cost type contracts contain more than one product service code (e.g., Maintenance, RDT&E, Service, etc..) which would necessitate the use of two different payment terms clauses to comply with the proposed rule. AIA members have also noted that the percent of cost type contracts with mixed effort is even greater when the review is performed at the appropriations level (e.g., RDT&E, O&MA, MP, etc.). In addition, we recently sampled 4000 fixed price DoD contracts awarded to AIA member companies and determined that over 8% of those contracts contain some form of cost type effort that would require the use of two or more payment clauses to comply with the rule.

Finally, we would like to conclude by commenting on the practice of making interest payments on late payments under cost type contracts for services. The guiding principles of the Federal Acquisition Regulation (i.e, FAR 1.102-2) state that “In order to ensure that maximum efficiency is obtained, rules, regulations, and policies should be promulgated only when their benefits clearly exceed the costs of their development, implementation, administration, and enforcement.” The Public Law passed in 2000 that provided interest payments on delinquent cost type contracts for services financing invoices was justified at the time. However, since the year 2000, there have been dramatic improvements in the timeliness and reliability of DoD payments that, in our opinion, no longer justifies the need for continued Prompt Payment Act interest coverage. Since 1999, payment turnaround times achieved by the DoD have improved by 28% and the overage percentage, which measures the rate of delinquent payments, has decreased by 85%. While delinquent payments are a serious matter, continuation of the current costly and administratively burdensome practice of paying interest on cost type services contract financing invoices and the revisions under consideration in this rule clearly exceed the benefit. It would make considerably more sense to pursue a repeal of the law and regulations requiring payment of interest on cost type contracts for services and revert back to treating their associated billings as contract financing not subject to the Prompt Payment Act. The repeal of the law would save the Government over \$4 million a year in interest and process costs.

For the several reasons stated above, we strongly recommend that this proposed rule be withdrawn. We welcome an opportunity to meet with the DAR Council to discuss our serious objections to the proposed rule. To arrange for such a meeting, or to receive clarification on any points made in this response, please contact Mr. Dick Powers of my staff on 703 358-1042. Dick can be reached by email at dick.powers@aia-aerospace.org.

Sincerely,

Robert T. Marlow
by Elaine J. Smith

Robert T. Marlow
Vice President, Acquisition Policy